

Bills Committee on Companies Bill

Follow-up actions for the meeting held on 18 November 2011 relating to Part 4

Purpose

This paper sets out the Administration's response to the issue raised by Members at the Bills Committee meeting on 18 November 2011 relating to clause 146 of Part 4 ("Share Capital") of the Companies Bill (CB).

Administration's response

Clause 146 - Registration of transfer or refusal of registration

2. Members asked whether the introduction of a right for the transferee or transferor of shares to request reasons for the company's refusal to register a transfer of the company's shares was inconsistent with the rights of a private company to restrict the right of transfer, and asked for information regarding relevant court cases.

3. The introduction of such right is not inconsistent with the right of a private company to restrict the right to transfer its shares. As defined in clause 10 of the CB, a private company is a company which, amongst other things, restricts a member's right to transfer shares. This is existing law and re-enacts section 29(1)(a) of the Companies Ordinance (Cap 32) (CO). There is no intention to change this.

Current law

4. A basic feature of registered companies is that their shares are freely transferable, and there is no power to refuse registration of a transfer unless the company's constitution gives a clear power to do so. In other words, there is a *prima facie* right for a shareholder to freely transfer his shares, which can only be altered by clear provisions to the contrary in the articles of association of the company. For a company to be a private company there must be a restriction on transfer in the articles

of association of the company¹. A restriction on transfer must therefore be clearly expressed in the articles of association of the company, and it will not be implied by the courts².

5. The standard restriction on the transfer of shares in a private company in Hong Kong is the power of the directors to decline to register as a member any transferee of shares, in their absolute discretion and without assigning any reason therefor, whether or not such share has been fully paid³. The principles to be applied in cases where the articles of the company confer a wide discretion on directors with regard to acceptance of transfers of shares, are clearly set out by Lord Greene MR in the case of ***In Re Smith and Fawcett, Limited***⁴:-

“They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose. They must have regard to those considerations, and those considerations only, which the articles on their true construction permit them to take into consideration, and in construing the relevant provisions in the articles it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases...the shareholder has such a prima facie right, and that right is not to be cut down by uncertain language or doubtful implications. The right, if it is to be cut down, must be cut down with sufficient clarity...Private companies are in law separate entities...they are much more analogous to partnerships than to public corporations. Accordingly, it is to be expected that in the articles of such a company the control of the directors over the membership may be very strict indeed. There are, or may be, very good business reasons why those who bring such companies into existence should give them a constitution which confers on the directors the powers of the widest description.”

¹ Section 29(1)(a) of the CO.

² *Greenhalgh v Mallard* [1943] 2 All ER 243, per Lord Greene MR at 237.

³ CO, the First Schedule, Table A Part II, Article 3 (Regulations For The Management Of A Private Company Limited By Shares).

⁴ [1942] Ch 304 at 306.

6. The common law position is that there is no need for the directors to give any reason for their refusal to register a transfer⁵ and the court will presume that they have acted properly⁶. As a result, it is very difficult in practice to challenge any decision of the directors to ensure that they have acted *bona fide* in the interest of the company in coming to their decision, unless reasons are voluntarily given by the directors.

7. Under section 69(1B) of the CO, where a company refuses to register a transfer of any shares, the transferee has a right to apply to the court to have the transfer registered. Again, however, in the absence of reasons for refusal, it is difficult for any applicant to prove that registration has been wrongfully refused, as it is for the person making the allegation that the director's decision is improper to prove it.

8. The position is different under the CO for a transmission of shares by operation of law. In such cases, there is a right under section 69(1A) of the CO to request the company to give reasons for a refusal to register. The company is required to register the transfer if it fails to give reasons within 28 days of the request for reasons.

CB Proposal

9. Under clause 146(3) of the CB, the proposal is to introduce a similar right to request reasons, as is available on transmission of shares by operation of law under section 69(1A) of the CO, to the transferor and transferee in relation to a share transfer.

10. We consulted the public on the issue during the second phase consultation of the draft CB⁷. The majority of the respondents commented on this issue supported our proposal⁸, considering that there

⁵ *Duke of Sutherland v British Dominion Land Settlement Corp* [1926] Ch 746.

⁶ *Re Gresham Life Assurance Society, ex parte Penney* (1872) LR 8 Ch App 446; *Re Coalport China Co* [1895] 2 Ch 404.

⁷ See Financial Services and the Treasury Bureau, *Consultation Conclusions on the Second Phase Consultation on the draft Companies Bill* (25 October 2010) (http://fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cssp_consultation_e.pdf), paragraphs 39 and 40.

⁸ Among the 36 respondents who commented on this subject, 21(including those from the Chinese General Chamber of Commerce, Chamber of Hong Kong Listed Companies, Hong Kong Association of Banks, Hong Kong Institute of Certified Public Accountants, Hong Kong Institute

was a need to enhance transparency and to ensure proper exercise of the directors' duties to the benefit of the company.

11. In the UK the position is more stringent and, the giving of reason is mandatory if the company refuses to register the transfer⁹.

Application of the CB proposal

12. The requirement for directors to provide reasons upon request does not mean that private companies can no longer restrict transfers of its shares pursuant to provisions in its articles conferring such a power. It will not interfere with a decision made legitimately, or substitute the court's decision for the directors' decision made in good faith, as to what they consider to be in the interests of the company. The new requirement does not change the legal principles applicable in deciding whether or not the directors' refusal to register a transfer is valid or not. The law remains that the directors must act in accordance with the articles of the company, and *bona fide* in what they consider to be the best interest of the company, and they must not act fraudulently, capriciously or for a collateral purpose.

13. There are various court decisions on the right to refuse registration¹⁰.

Conclusion

14. The right to request reasons in a transfer situation, similar to the right available under the CO in a transmission situation, will enhance

of Directors and Law Society of Hong Kong, agreed that reasons should be provided; while 13 respondents (including Hong Kong General Chamber of Commerce and Society of Chinese Accountants and Auditors) disagreed; and two offered other comments.

⁹ Section 771 of the UK Companies Act 2006.

¹⁰ See for example *Simon Fireman v Golden Rice Bowl Ltd* [1987] HKLR 981: where the court considered an application against refusal where the applicant was a chargee of the shares and observed that it was not entitled to interfere with a decision just because it disagreed with it, nor would it exercise its discretion so as to defeat the objects of the company. It would generally not be appropriate for the court to override a refusal to register where the transaction is temporary, such as mortgage of shares, *Choy Bing Wing v Max Share Ltd* [1993] HKCU 300. In *Lee Chee Ngor Moreta v Prudential Enterprises Ltd* [1991] 2 HKC 499, the court would not interfere with the refusal to register the widow and administratrix of a deceased member, which was in accordance with the articles of the company, despite the family nature of the company.

transparency and will make it easier for shareholders to take action where they consider that the directors have not acted in accordance with the law, but the rights of private companies to impose restrictions on the transfer of their shares will not be affected.

**Financial Services and the Treasury Bureau
Companies Registry
2 December 2011**